This record is a partial extract of the original cable. The full text of the original cable is not available.

141952Z Apr 05

C O N F I D E N T I A L CARACAS 001088

SIPDIS

TREASURY FOR OASIA - SIGNORELLI
NSC FOR SHANNON/BARTON

E.O. 12958: DECL: 04/14/2015
TAGS: EFIN ECON PGOV VE
SUBJECT: VENEZUELA'S FINANCIAL SECTOR FACING MORE POLITICAL INTERFERENCE

Classified By: Economic Counselor Richard M. Sanders. Reason:1.4(b) and (d).

-------
Summary
-------

¶1. (C) Several issues are causing heads to turn in Caracas financial circles. It is rumored that the Central Bank is unloading its U.S. treasury instruments, for fear that they might be vulnerable to a U.S. economic embargo on Venezuela. Meanwhile the Finance Ministry has successfully carried out a USD 1.6 billion bond issue, that like previous ones, implicitly allows investors to exchange money at nearly same rate as that available on the parallel market. At the same time the latest draft of the bill which would impose criminal sanctions for parallel exchange transactions remains tough in its penalties and far-reaching in its scope. Leading bankers are still under criminal investigation for alleged "usury" on loans made in the 1990's. One banker fears that this could be a prelude to a state takeover of at least one bank. End summary.

-----------------------------------------
Central Bank Divesting From US Securities?
-----------------------------------------

¶2. (C) On April 6, Nelson Ortiz, President of the Caracas Stock Exchange (please protect) told econcouns that he had been reliably advised that the Central Bank had been progressively divesting itself of its in U.S. treasury instruments, held in U.S. banks. He suggested that the Bank would probably put the money into dollar-denominated instruments held in Europe. Ortiz said that he understood that the decision was made to enable Bank management to tell President Chavez that they were taking precautions to avoid the seizure of GOV assets by the USG in the event of any confrontation.

¶3. (C) Note: As of December 31, 2004, the Bank had USD 5.195 billion invested in foreign public securities, mainly U.S. treasury securities. We are told by a former Central Bank official that "most of these" were in U.S. treasury instruments. The rest of the Bank's reserves consisted of USD 10.984 billion in certificates of deposit in foreign commercial banks, USD 5.122 billion in monetary gold, USD 1.147 billion in liquid available foreign exchange, USD 500 million in its IMF position, USD 8 million in special drawing rights, and USD 710 million in its Macroeconomic Stabilization Fund. End note.

-----------------------------------------
New Bond Issue A Window For Buying Dollars
-----------------------------------------

¶4. (U) The Finance Ministry successfully concluded a USD 1.6 billion bond issue on April 7. This issue, which followed a euros 1 billion issue concluded in March, marks a reversion back to the formula devised by former Finance Minister Nobrega ) the "combo" in which the bond, which in this case has a 20 year duration and pays interest of 7.65 pct, can be purchased in bolivars at the official exchange rate of 2150 bols/dollar. As local analysts note, the tremendous benefit to purchasers of being able to use the official rate is largely clawed back by the fact that the interest given is well below what other GOV instruments have paid, such as its 2018 bond which pays interest of 9.0 pct and its 2027 bond which pays 9.2 pct.

¶5. (C) Alejandro Grisanti, Executive Director of Econalitica, a Caracas economic consulting firm calculates that buying this bond is the equivalent of buying a bond which pays a full market rate and selling bolivars at a rate of 2529 bols/dollar. This is only slightly better than the parallel exchange rate (currently around 2650 bolivars/dollar). It does, however, have the advantage, especially prized by the treasurers of multinational corporations operating here, that this allows bolivars that

cannot successfully be converted through the GOV's Foreign Exchange Administration (CADIVI) to be exchanged without recourse to the legally questionable parallel market.

----------------------------------------

Whither the Foreign Exchange Crimes Law?
----------------------------------------

¶6. (U) Indeed, the bond issue has become an element in the debate over the effort to draft a bill establishing criminal penalties for parallel market foreign exchange transactions. (Currently, the decree issued in 2003, in the aftermath of the general strike which shut down petroleum production, Venezuela's principal generator of foreign exchange, requires that all transactions be made through CADIVI, but does not establish any penalties for failing to do so.) The latest version of the legislation to emerge from the National Assembly's Finance Committee defined foreign exchange to include "any monetary expression, including paper money, bills, or any other instrument with a value other than in bolivars" and imposed a penalty of two to six years for the "purchase, sale, transfer, receipt, export or import" of USD 10,000 or more in foreign exchange in the course of one year. When an opposition deputy asserted that this legislation would make actions such as the bond issue, denominated in dollars although payable in bolivars, illegal, Finance Committee Chairman Rodrigo Cabezas (of the pro-Chavez Fifth Republic Movement) withdrew the draft, pending consultations with the Finance Ministry.

¶7. (C) In a breakfast with the Ambassador on April 7, the leadership of the Venezuela-U.S. Chamber of Commerce and Industry (VENAMCHAM) expressed their concern regarding the exchange crimes bill. They noted that they had earlier sought out dialogue with the National Assembly but that the areas which they had criticized remained in subsequent drafts, or had even been worsened in their view. Features which the business community finds especially objectionable include the, in their view, harsh sentences which are to be imposed for violations and the imposition of criminal responsibility for corporations and senior managers for the acts committed in their name by low ranking employees, without requiring their knowledge of or participation in the act.

---------------------------------------------
Case Against Bankers a Prelude to a Takeover?
---------------------------------------------

¶8. (C) The leadership of Venezuela's banks remain under investigation on possible criminal charges for alleged usury for their issuance of inflation-indexed loans in the 1990's. (When inflation zoomed up, in many cases the banks extended the life of the loans, allowing borrowers to maintain the same monthly payment as they had been doing earlier. While this avoided immediate default, the result was, inevitably, that after lengthy periods of making monthly payments, borrowers found that they still owed the entire principal on their loans.) Although the bankers are confident that their lending practices were perfectly legal, while the investigation continues, they are unable tl leave the country without court permission.

¶9. (C) Two bankers facing the investigation took very different perspectives in separate conversations with econcouns. On April 7, Gustavo Marturet, President of locally-owned Banco Mercantil, said that he viewed the investigation as probably an example of pro-Chavez prosecutors and judges seeking to prove their commitment to the GOV and their toughness on the business community, which is viewed as politically hostile. He expressed confidence that eventually the investigation would end without charges.

¶10. (C) However, Juan Carlos Escotet, president of rival bank BANESCO, took a bleaker view in a March 19 conversation. The GOV, he suggested, wants to re-enter the commercial banking system. (There are GOV efforts to re-establish state-owned enterprises in food distribution and processing, aviation, telecommunications, and paper manufacturing. The strategically vital banking system would be a logical follow-own.) He thought it likely that by moving ahead with a prosecution, the GOV hoped to force at least one banker to flee the country. That would be a prelude to the GOV's then pressuring the bank's owner to sell it the bank, which would then be merged with various existing (if moribund) state banks, such as the Banco Industrial de Venezuela. Escotet said that at least one foreign-owned bank whose local manager is being investigated in the usury case is "fed up" with

Venezuela, and may be prepared to sell out. (He mentioned no names, but "Banco de Venezuela," owned by Spain's Banco

Santander, fits this description.)

-------
Comment
-------

¶11. (C) Whether it is the rumored dumping of U.S treasury instruments by the Central Bank, the highly discretionary draft exchange crimes bill, or the pressures on prominent bankers, financial activity seems ever less governed by economic fundamentals and ever more by GOV political priorities.
Brownfield

NNNN
2005CARACA01088 - CONFIDENTIAL